Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-351

STATE OF ALABAMA,

Petitioner,

vs.

ROCKAWAY CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the Court of Civil Appeals of the State of Alabama

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BRIEF IN OPPOSITION

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QUESTION PRESENTED

For purposes of applying its own lease tax statute is the State of Alabama prohibited by the Patent Act from classifying as non-taxable royalties, certain portions of payments made by a lessee after the expiration of a lessor's patent rights.

STATEMENT OF THE CASE

This case involves an assessment by the State of Alabama under its Lease Tax law for the period July 1, 1971, through March 31, 1973, which totalled, including all penalties and interest, less than $8,000.

Rockaway Corporation (hereinafter "Rockaway") manufactures various machines which produce wire bound boxes. These machines are leased to box producers in a number of states and foreign countries. At one time Rockaway held patents for some of its box making machines, but the last of these expired during the 1950's.

Rockaway performs substantial services for each of its lessees. As the trial court noted, these services constitute a "vital and essential role" in the individual box manufacturer's sale of wire bound boxes. Included services are advertising, promotion, training of lessee's sales and service personnel, cost control, quality control, inspection at various warehouses, engineering support and new product development. Rockaway maintains a package research laboratory, and works closely with the ultimate users of wire bound boxes to develop new applications for wire bound technology. (A more complete list of the extensive services provided is found in the trial court's opinion at P. 18). In the words of the trial court:

> Based on such evidence, the Court finds that Rockaway's basic business is not that of renting machinery, but is the business of supplying services in connection with the sale of wire bound wooden boxes. [P. 18].

Rockaway is paid by box manufacturers in two ways. First, it receives fixed amounts as rent over a limited period of time for the right of the lessee to possess and use the machines. Rockaway has never contested the taxability of such fixed rentals under the Alabama Lease Tax law. Second, Rockaway receives a percentage of the lessee's proceeds of sales of boxes which are made on the machines. It is the taxability of these "variable" payments under Alabama's Lease Tax law that formed the basis of the state proceedings in this matter.

Rockaway has only one lessee in Alabama, T.R. Miller Mill Company (hereinafter "Miller"). While this business relationship dates back to 1931, the focus of the instant litigation is on a 1946 "Lease and License Agreement" which had a term of 25 years, but which was renewed for an additional 25 years by Miller in 1970. Over the years, under this Agreement Miller has paid $176,225 in fixed rentals for the various machinery it has acquired, and considerably more than that as variable payments. With respect to certain boxes, Miller's variable payment is 4% of its sales; on others, 2% of its sales. The President of Miller testified at the trial below that were it not for the extensive services provided by Rockaway, Miller would not in any way be able to make these variable payments [P. 18].

Under its Lease Tax law, Alabama imposes a tax on rental income, but not on service income or royalty income. During the course of this litigation Rockaway has maintained that the variable payments received from Miller constitute non-taxable service income. After a review

of the evidence presented, the Circuit Court agreed that all variable payments were indeed service income and therefore not taxable [P. 19].

On appeal by the State, the Court of Civil Appeals held that as a matter of Alabama law, the classification of the payments for purposes of the Alabama Lease Tax turns on the intention of the parties at the time of contracting. So viewed, the Court found that at the time of the 1946 Agreement it was the intention of the parties that all of the 4% payments and certain of the 2% payments were royalties under the lessor's then subsisting patent rights, and therefore not taxable under Alabama law. The balance of the 2% payments were found by the Court to be taxable rentals. In so ruling the Court stated:

> It is imperative to note that at the time of the agreement between the parties, the patents to those boxes were held by Rockaway. We deem it immaterial that these patents have now expired for the Miller Company is paying Rockaway for the benefit it derives from the sales of these patented boxes. [P. 28]

Dissatisfied with this result, which was clearly more favorable to the State than the trial court decision, the Alabama Attorney General moved for rehearing contending that the payment of a royalty beyond the expiration of a patent is unlawful. The Court of Civil Appeals overruled the application for a rehearing, noting again in a supplemental opinion that the taxability of the payments was based upon a construction of the contract. The Court added that the fact that one of the parties might not have to abide by the contract did not make payments under the contract taxable by the State of Alabama [P. 30]. Thereafter, the State pressed the same argument before the Alabama Supreme Court by way of *certiorari*, but the writ was denied [P. 31].

ARGUMENT

The petition should be denied because the petitioner has not presented a substantial federal question.

The essence of the Alabama Attorney General's petition in this Court is that in applying an Alabama Lease Tax the Alabama Court erred in construing the nature of certain payments so as to render them non-taxable under Alabama law. This assertion is coupled with an astonishing request that this Court direct an Alabama court to construe the payments in question in such a way as to render them taxable.

In the Alabama proceedings the taxpayer claimed that, *for tax purposes*, the payments in question should be construed as payments for services and, therefore, totally excludable. The Alabama taxing authorities claimed that, *for tax purposes*, the payments constituted rents and, therefore, totally includable. The final determination by the Alabama Court of Civil Appeals was that the payments were originally intended to be a combination of rents and royalties and, therefore, under the Lease Tax law partially includable and partially excludable.

As even the State of Alabama we think will concede, there is absolutely nothing in the Patent Act, or in any of the cases which have interpreted it, or in any of the patent misuse cases, which requires any State to impose or to refrain from imposing a tax on royalties paid under expired patents. As authoritatively construed by the State Court, Alabama in fact does not impose such a tax. In these circumstances it is difficult to perceive a federal issue, the resolution of which could alter the decision of the Alabama Court in this case.

Petitioner relies upon *Brulotte v. Thys Co.*, 379 U.S. 29, 85 S.Ct. 176, 13 L.Ed.2d 99 (1964). There this Court (over the interesting dissent of Justice Harlan) sustained the defense of patent misuse so as to render unenforceable an agreement entered into under circumstances which clearly showed an attempt on the part of a patent holder to use leverage arising from his patent monopoly, *i.e.*, "patent power," to exact royalties beyond the period of the patent grant.[1]

Miller, the other party to the contract in the instant case, has never claimed that it was not obligated to make the variable payments in question. In fact, both parties are completely satisfied with their business relationship. The non-party attacking the agreement is the State of Alabama seeking to impose a tax. No case cited by the Petitioner involved a third person. We know of no case which would give someone not a party to a contract standing to attack it alleging patent misuse.[2]

Rockaway did not challenge below, and accepts *arguendo* here, the legal principal that any contractual obligation on Miller's part to make "royalty" payments on expired patents could be successfully resisted by Miller. However, we fail to see how, as a matter of federal law, this principal requires such payments, if made, to be

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1. There is no finding in the case at hand that Rockaway had, as an economic fact, "patent power," much less misused it. Indeed, after all patents had expired Miller voluntarily renewed the agreement. *Compare* Zenith Radio Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 89 S.Ct. 1562, 23 L.Ed.2d 129 (1969).

2. In United States v. Glaro Group Ltd., 302 F.Supp. 1 (D.D.C. 1969), one District Court held that not even the Antitrust Division can sue to have patent rights declared unenforceable for misuse of patent where a defendant refuses to raise the defense of patent privilege to an antitrust complaint.

otherwise labeled so that they may be taxed by the State of Alabama.[3]

The Alabama Court did not decide this case in ignorance of federal law regarding misuse of patents. The State pressed this point on rehearing. The Court of Civil Appeals expressly found that federal law was not relevant to its construction of the Alabama taxing statute. What the State asks this Court to do is to take upon itself the interpretative powers of the Alabama Courts and broaden by independent construction the reach of the Alabama Lease Tax law. To assume such powers would be a startling departure by this Court from the principles of federalism expressed in *Erie R.R. v. Tompkins*, 304 U.S. 69, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). Furthermore, to broaden this tax by construction would be to flout the Alabama policy that state taxing statutes are to be strictly construed. *State v. GM&O Land Co.*, 49 Ala.App. 707, 275 So.2d 687, *cert. den.*, 290 Ala. 371, 275 So.2d 690. If the Alabama taxing authorities believe that the Alabama Courts have too narrowly construed an Alabama statute, their recourse is to Alabama's legislature not to this Court.

3. Moreover, the Alabama Court held as a matter of state law that it was the intention of the parties *at the time of contracting* (1946, when the patent rights were in existence) which was the critical fact upon which taxability turned under the Alabama Lease Tax law; *Brulotte* was not even decided until 1964.

CONCLUSION

The Courts of Alabama have found as a matter of state law that certain payments are not taxable under the Alabama Lease Tax. Since no federal issue is involved in such a determination, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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